STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the Matter of the Application of AMERITECH COMMUNICATIONS, INC. for a License to Provide Basic Local Exchange Service to Ameritech Michigan and GTE North, Inc. Exchanges in Michigan	)))))))	Case No. U-11053

REPLY BRIEF
OF TCG DETROIT, INC.

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Dated: June 24, 1996

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REPLY BRIEF OF TCG DETROIT, INC.

Pursuant to the hearing schedule established by the Administrative Law Judge in this proceeding, TCG Detroit, Inc. ("TCG") replies to the Initial Brief submitted by Ameritech Communications, Inc. ("Ameritech Communications"). In this Reply Brief, TCG responds to certain of the assertions and arguments raised by Ameritech Communications in its Initial Brief. The fact that TCG does not provide a response in this Reply Brief to each and every assertion or argument raised by Ameritech Communications must not be construed to mean that TCG supports or agrees with such assertion or argument or that it is waiving its objections or positions on the issues addressed by such assertion or argument. This Reply Brief must be read in conjunction and in concert with TCG's Initial Brief submitted on June 17, 1996 in this case.

ARGUMENT

I. AMERITECH'S APPLICATION FOR A LICENSE TO PROVIDE BASIC LOCAL EXCHANGE SERVICE IS REALLY INTENDED TO ACT AS A VEHICLE IN WHICH TO CIRCUMVENT COMPETITIVE SAFEGUARDS IN PROVIDING INTERLATA LONG DISTANCE SERVICE

Throughout its Initial Brief in this case, Ameritech Communications repeatedly asserts that the purpose of its application for a license to provide basic local exchange service is to be able to provide customers with "one-stop shopping," so as to offer "integrated packages" of local exchange and interLATA long distance phone services once Ameritech Communications is able to obtain "appropriate approvals." *ACI Brief, pp 7, 9, 12, 23, and 47.* However, the record evidence in this case demonstrates that Ameritech's real objective in seeking a license in this case is to allow it, through the guise of a license for basic local exchange, to circumvent competitive safeguards for affiliates of incumbent monopoly Regional Bell Operating Companies in connection with the provision of interLATA long distance service.

Ameritech goes to great pains in its direct presentation and in its Initial Brief in this case to convince the Commission that the creation of Ameritech Communications and its anticipated corporate and operating relationship with its parent, Ameritech Corporation, and with its affiliate, Ameritech Michigan, are intended to comply with the statutory competitive requirements and safeguards embodied in the federal Telecommunications Act of 1996 ("FTA") and the Michigan Telecommunications Act of 1995 ("MTA"). See, *3 Tr 277; 4 Tr 554-556; ACI Brief, pp 2, 5, 27, 45, 48, 50 and 54.* Apparently, Ameritech intends to have it shown that, through the granting of a license by the Commission in this case, it will have complied with the competitive safeguards of the FTA so as to facilitate its entry into the provision of interLATA long distance service. Cross-examination of Ameritech Communications' witnesses revealed its true objectives with respect to its request for a license in this case, however. During cross-examination of Ameritech's witness David Teece, it became abundantly clear that Ameritech Communications' overarching interest is entry into and competing in the interLATA long distance market. For example, Dr. Teece testified repeatedly that Ameritech Communications' interest in the provision of local exchange is ancillary to its real business focus of competing with AT&T, MCI and Sprint in the long distance market.[1] When asked a series of questions about whether Ameritech Communications, as Ameritech Michigan's "competitor" in the local exchange market, may have access to information on Ameritech Michigan's network, Ameritech's witness Teece revealed Ameritech Communications' real objectives in this case:

> Q. You would agree, also, that ACI since it's competing with Ameritech Michigan for at least some business also should not have access to certain information; correct?
>
> A. Well, from ACI's competitors like AT&T and Sprint and MCI, yes.
>
> Q. No. No. No. I'm talking about Ameritech Michigan information.
>
> A. Yes. But remember -- I mean, this is a point I made last time. **The fact that ACI and Ameritech are competitors is purely ancillary to the fact that ACI is trying to go and compete against AT&T.** I think it's more proper from an economic point of view to see ACI as primarily a purchaser from Ameritech. So it's more a buyer-supplier relationship rather than a competitive one. That just sort of is ancillary fallout to the fact that they're trying to design a business model that will enable them to go compete against AT&T, MCI, Sprint and the other long distance carriers.

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[1]In its Initial Brief, TCG cited to numerous references in this record at which Ameritech Communications revealed its true underlying objectives with respect to its obtaining a license to provide basic local exchange service in this case. See *TCG Brief, pp 4-10*. Therefore, TCG does not believe it is necessary to recite all of these references. However, TCG believes that restating certain portions of this testimony is useful in demonstrating just how transparent are Ameritech Communications' true objectives with respect to its application.

Q. And so the focus of the Commission should be on setting up an entity that can compete against AT&T; correct?

A. I'm not saying precisely that. I'm saying to understand why the certification is important. <u>I think you have to recognize what the fundamental strategic thrust here is, and that's to go compete in the long distance market</u>. Now, I mean, there's lots of things the Commission has to consider, but if it doesn't do so in that context I think it would be hard to understand what's really going on here.

6 Tr 1088-1089 (Emphasis added). When asked questions about the possibility of discrimination by Ameritech in favor of its affiliate, Dr. Teece again reiterated Ameritech's true objectives with respect to its application for a license in this case:

Q. And so your -- it's your position that Ameritech basically will never violate the discrimination rules or --

A. Well, no, not necessarily, although I would hope that would be the case. There's all kinds of penalties, and, as I said before, there is the -- <u>the larger environment here is one where Ameritech is trying hard to get permission to compete in long distance, and if there's a litany of evidence that they have not been in compliance, they won't be able to get what they're truly after</u>.

6 Tr 1096 (Emphasis added).

While proclaiming in its application, and through the direct written testimony of its witnesses, that it desires to provide basic local exchange service to customers, Ameritech Communications witnesses again revealed during cross-examination just how disingenuous these purported intentions are. For example, Ameritech witness M. Ryan Julian testified that he could not state whether Ameritech Communications would continue to exist if Ameritech decided to establish another affiliate which might provide long distance service only, or if Ameritech Michigan were to enter the long distance market after the three year minimum period under FCC rules expired and were to offer "one stop shopping." *4 Tr 601-603*. In addition, in response to a question about the possibility of duplicate costs resulting from Ameritech employees working for Ameritech Communications and Ameritech Michigan, Ameritech witness Teece stated:

> Well, I wouldn't expect duplication of that kind. **And if ACI did have the permission to enter the local -- had local certification before it had permission to go long distance, it's not necessarily going to spend money for the sake of it. I mean, it's going to, as I understand it, prepare to compete in the long distance market.**

6 Tr 1109 (Emphasis added). In other words, Ameritech Communications would not invest in basic local exchange in the absence of authority for the provision of interLATA long distance service; instead it would wait to invest in order to compete in the long distance market. As can be seen, the record in this case clearly shows that Ameritech's overarching interests in establishing Ameritech Communications and seeking a license in this proceeding is to compete in the long distance market, not to provide basic local exchange service, and, contrary to Ameritech's assertions, not to offer customers "one stop shopping" capabilities. Apparently, Ameritech hopes that Commission approval of its license in this case would legitimize its purported plan to comply with statutory competitive safeguards. Therefore, the Commission should be extremely skeptical in evaluating Ameritech Communications' application in this case. TCG submits that in carefully evaluating the evidence in this case, and by looking through Ameritech Communications' proffered assertions that it wishes to provide local exchange service and/or "one stop shopping," the Commission will understand, as Dr. Teece stated, what Ameritech is "truly after"[2] in this case, that is to compete in the long distance service market.

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[2] *6 Tr 1096*.

II. AMERITECH COMMUNICATIONS' STATED ASSURANCES OF CONDUCTING ARMS-LENGTH TRANSACTIONS WITH ITS AFFILIATES ARE INCREDIBLE GIVEN THAT HERETOFORE IT HAS FAILED TO DO SO WITH RESPECT TO ITS PARENT AMERITECH CORPORATION

Throughout its Initial Brief, Ameritech Communications repeatedly asserts that all transactions with the Ameritech Michigan will be conducted on an arm's length basis and that all such transactions shall be reduced to writing and available for public inspection. *ACI Brief, pp 10, 26, 40, 46 and 50.* Ameritech Communications' assertions are incredible given the irrefutable evidence in the record in this case. Ameritech Communications' Vice-President of Finance and Administration, Patrick Earley, testified that Ameritech Corporation has to date already "loaned" to Ameritech Communications approximately $90 million to prepare for operations. *4 Tr 449.* Over 95% of this amount has been in the form of **unsecured** debt, and such transactions have **not been reduced to a written agreement**, in which the terms and conditions of the transaction are specified. *4 Tr 455.* Despite being Ameritech Communications' Vice President of Finance and Administration, Mr. Earley could not identify what the terms of the loan are nor the period in which Ameritech Communications is to pay back Ameritech. *4 Tr 456.* TCG witness Dr. Paul Teske correctly characterizes this transaction as a gift as opposed to a bona fide loan. *4 Tr 913.* Mr. Earley also could not identify what portions of this $90 million were for direct versus indirect costs, *4 Tr 426*, nor the percentages for long distance services versus local exchange services, *4 Tr 440-441*, nor the amount which has been invested in Michigan. *4 Tr 449.*

How can this Commission take Ameritech Communications at its word that transactions between it and its affiliate Ameritech Michigan will be at arm's length and reduced to writing when it has already obtained approximately $90 million from its parent Ameritech Corporation without providing any security and without reducing that transaction to writing? Furthermore, how can this Commission accept Ameritech Communications representation that it intends to make public the records of these transactions, when it failed to provide with its application in this case documentation and information, such as annual financial statements or balance sheets, which might help to identify the nature of these transactions? So far, Ameritech's behavior belies its stated intentions. Based on this history and the lack of information presented by Ameritech Communications in this proceeding, it is clear that the relationship between Ameritech Communications and its affiliates is fraught with dangers of cross-subsidization and discrimination against unaffiliated competitors and thus the Commission should reject Ameritech Communications' request for a license.

III. AMERITECH COMMUNICATIONS' REFERENCE TO EXTRA RECORD INFORMATION IN ITS BRIEF IS IMPROPER AND SHOULD BE STRICKEN

On page 22 of its Initial Brief, in connection with its discussion of the emerging competition in the basic local exchange, intraLATA toll, interLATA long distance and other telecommunications service markets, Ameritech Communications refers to (and attaches to its Brief as "evidence") an article published in the Wall Street Journal, which purports to describe the business strategies envisioned by AT&T in competing in these markets. TCG submits that Ameritech Communications' reference to this material is improper.

Under both the Michigan Administrative Procedures Act ("MAPA") and the Commission's Rules of Practice and Procedure, such extra-record evidence cannot be considered in the Commission's determination of this case. Section 76 of the MAPA states in pertinent part:

> Evidence in a contested case, including records and documents in possession of any agency of which it desires to avail itself, shall be offered and made a part of the record. Other factual information or

> evidence shall not be considered in determination of the case, except as permitted under section 77.[3]

(Emphasis added).

The Commission's Rules of Practice and Procedure provides a similar requirement. Rule 325(2) of the Commission's Rules states in pertinent part:

> Evidence, including records and documents in the possession of the commission, that a party desires or intends to rely on shall be offered and made a part of the record in the proceeding and other factual information or evidence shall not be considered in the determination of the case, except as otherwise permitted by law.

R 460.17325. (Emphasis added). This article is hearsay evidence, it was not made a part of the official record in this proceeding and it was not subject to cross-examination. It is therefore improper for Ameritech Communications to refer to this material and the Commission cannot give it any consideration in the determination of whether to grant Ameritech Communications a license in this case. Thus, the referenced material should be stricken from its brief.

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[3]Section 77 allows an agency in a contested case to take official notice of judicially cognizable facts, and may take notice of general, technical or scientific facts within the agency's specialized knowledge. (MCL 24.277) Neither of these situations exist here.

WHEREFORE, for the foregoing reasons and for the reasons set forth in its Initial Brief, TCG Detroit respectfully requests that the Commission deny Ameritech Communications' application for a license to provide basic local exchange service in the service territories of Ameritech Michigan.

Respectfully submitted,
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TCG DETROIT, INC.'S EXCEPTIONS
TO THE PROPOSAL FOR DECISION

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TABLE OF CONTENTS

Page

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TCG DETROIT, INC.'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

Pursuant to the Notice of Proposal for Decision issued on July 19, 1996, TCG Detroit, Inc. ("TCG") submits the following exceptions to the Proposal for Decision ("PFD") issued by Administrative Law Judge Frank V. Strother ("ALJ") in this proceeding. In its Exceptions, TCG responds or objects to portions of the ALJ's PFD which it believes requires response. TCG's response in these Exceptions, however, does not supplant its positions and arguments contained in its earlier filed Initial Brief and Reply Brief. These Exceptions must be read in concert with those earlier filed briefs to properly understand TCG's positions in this case.

ARGUMENT

I. THE ALJ ERRED IN BASING THE GRANTING OF A LICENSE FOR BASIC LOCAL EXCHANGE ON THE IMPACT IT MIGHT HAVE ON COMPETITION IN THE MARKET FOR ALL TELECOMMUNICATIONS SERVICES

The ALJ contends that several of the parties view this proceeding too narrowly as involving only the market for basic local exchange service. The ALJ asserts that this proceeding, initiated pursuant to Ameritech Communications Inc.'s ("ACI") request for a license to provide basic local exchange service, should focus on the market for all telecommunications services, not just on basic local exchange service. The ALJ then contends that the "**determining question**" in this case is whether the market for all telecommunications services would be more or less competitive if ACI were "permitted entry" into the market for the full range of telecommunications services, and that the result in this case should be one which would maximize competition across the "entire spectrum of telecommunications." (PFD, pp 10-12). Based upon this "determining question," the ALJ then finds that granting a license to ACI to provide basic local exchange service would increase competition in the marketplace for all telecommunications services. (PFD, p 23).

TCG submits that the ALJ's perspective of basing the grant of a license for basic local exchange on the market for all telecommunications services mischaracterizes the proper scope of this proceeding. TCG does not deny that the request for a license to provide basic local exchange services may be considered in the larger context of its effect on the markets for other telecommunications services. Indeed, TCG demonstrated in its Initial Brief how granting ACI a license in this case might retard competition in the markets for basic local exchange and interLATA long distance services. (TCG Brief, pp 10-27). However, the "determining question" in a proceeding regarding a license for basic local exchange is not its effect on competition in the market all for telecommunication services. ACI's request for a license to provide basic local exchange service cannot properly be equated with a request for permission to enter the markets for all telecommunication services. In determining whether to grant a request for a license to provide basic local exchange service the Commission must focus on the impact that granting a license would have in the market for basic local exchange services.[1] Therefore, the ALJ has improperly expanded the

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[1]In its Opinion and Order which reversed the ALJ's March 18, 1996 ruling denying the intervention of various of the intervenors in this case, the Commission stated as follows:

focus of this proceeding, and thus has improperly based his finding on matters not central to issues properly before the Commission.

The ALJ suggests that "permitting" ACI "entry" into the market for telecommunications services would increase competition in the market for these services. The record evidence in this case demonstrates, however, that the relationship between ACI and its affiliate Ameritech Michigan, the incumbent monopoly provider of basic local exchange services for the past century, has a serious potential for significant abuse which would impair true, effective competition in the markets for basic local exchange and other telecommunications services.

II. ACI'S APPLICATION FOR A LICENSE IN THIS CASE SUGGESTS A DESIRE TO AVOID COMPETITIVE SAFEGUARDS IN PROVIDING INTER-LATA SERVICE RATHER THAN A GENUINE DESIRE TO PROVIDE BASIC LOCAL EXCHANGE SERVICE

In focusing on ACI's "entry" into the markets for all telecommunications service, the ALJ underscores a serious problem raised by ACI's presentation in this proceeding. That is what is ACI really seeking to accomplish in this case through a granting of a license for basic local exchange? ACI represents in its Application that it desires a license to provide basic local exchange service in Ameritech Michigan and GTE North's exchanges in Michigan and authority to provide basic local exchange services on a resold basis. ¶ 3 of Application. ACI then states that it plans to offer its customers "full service" options and provide "one-stop shopping" service which would include long distance, local and other services. ¶ 4 of Application. Ameritech's witnesses during

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In reaching this conclusion, the Commission notes that the scope of this proceeding is narrow: Does ACI possess sufficient technical, financial, and managerial resources and abilities to provide basic local exchange service to every person within the geographic area of the license and would it be contrary to the public interest to grant the license? (Opinion and Order, April 10, 1996, pp 6-7).

cross-examination revealed Ameritech's real objective in requesting a license. Ameritech's request for a license in this case is related less to a desire to provide local exchange service and more to attempting to circumvent the statutory competitive safeguards for affiliates of incumbent monopoly Bell Operating Companies in connection with the provision of interLATA services. As discussed above, by viewing ACI's license request as permission to enter the market for all telecommunications, the ALJ appears to have expanded the scope of this case beyond what it should properly be focused on. Consequently, the results of adopting his recommendations without any qualifications or modifications would have serious adverse ramifications on the markets for interLATA and other services. In its Initial Brief and Reply Brief, TCG pointed to evidence which revealed what ACI's true intentions appeared to be with respect to its request for a license in this case. TCG demonstrated that ACI was really focused on the market for long distance services, and not on local exchange services. TCG argued that issuance of a license to ACI would be a vehicle in which to circumvent the competitive checklist requirements for incumbent monopoly Bell Operating Companies entering the long distance market. Attached to these Exceptions and incorporated herein are copies of the portions of TCG's Initial Brief and Reply Brief address this issue (See Attachment A and Attachment B, respectively). The ALJ's perspective in this case of viewing the public interest with respect to all markets creates the possibility of confusion and improperly expands the scope and potential impact of this proceeding. It is therefore critical that if the Commission were to grant ACI a license in this case, which TCG submits would be contrary to the public interest, it should be clear as to what the impact of granting such a license would be on the relevant markets for telecommunication services and that the Commission expressly limit its findings as to whether ACI has met the requirements contained in Section 302(1) regarding the provision of basic local exchange service only.

III. THE ALJ ERRS IN FINDING THAT STATUTORY STRUCTURAL REQUIREMENTS ALONE ARE SUFFICIENT TO PROTECT CONSUMERS AGAINST AFFILIATE ABUSES

In his PFD, the ALJ contends that structural separation requirements contained in the federal Telecommunications Act ("FTA"), and the Michigan Telecommunications Act ("MTA"), would sufficiently safeguard against affiliate abuse by ACI and its affiliate Ameritech Michigan with respect to cross-subsidization of ACI by Ameritech Michigan and discriminatory treatment by Ameritech Michigan in favor of ACI over unaffiliated local exchange providers. (PFD, pp 20-21). The ALJ asserts that the separation requirements in these statutes would sufficiently ensure that ACI is a truly separate subsidiary, conducts all its transactions with Ameritech Michigan on an arm's length basis, and that such transactions would be reduced to writing. (PFD, pp 16-18). The ALJ ignores the <u>substantial record evidence which demonstrates the opposite</u>. ACI has failed to demonstrate that the structural separation requirements, as implemented by ACI and Ameritech, adequately safeguard against affiliate abuse. In fact, the relationship and transactions between ACI and Ameritech has heretofore shown that such abuses have already occurred and are likely to occur, despite the existing statutory proscriptions against affiliate abuse. For example, and as is discussed more fully below, ACI has already received in "loans" over $90 million from its parent company Ameritech <u>merely on the basis of an oral agreement</u>. ACI provided no security to Ameritech for incurring this debt, and the terms for repayment of these monies are undefined. (4 Tr 455-456). How can the Commission reasonably accept ACI's and the ALJ's contentions that existing statutory requirements are sufficient to safeguard against affiliate abuse when ACI and Ameritech already appear to be violating those statutory restrictions?!

Several independent expert witnesses in this case explain why the separation requirements in the MTA and the FTA do not, in and of themselves, adequately protect against potential affiliate abuse by ACI or Ameritech Michigan. TCG Detroit's expert witness Dr. Paul Teske[2] testified:

> Q. Do you agree with ACI Witness Dunney (sic) that the structural separation and other requirements embodied in the FTA will "protect consumers and ensure the growth of competition?"
>
> A. No, I do not agree. Ameritech Michigan, ACI's affiliate, has, by its own admission not met the requirements of the FTA with respect to structural separation requirements, and it has not obtained approval to provide in region interLATA service. I do not see how ACI can then assert that it has met these same requirements or that they are sufficient to protect customers.

(5 Tr 906). AT&T Communications of Michigan, Inc. ("AT&T") witness Cathleen M. Conway, AT&T Corporation's Regulatory Manager in its Central Region Government Affairs Division had a similar opinion.

> Q. Was ACI formed as a separate subsidiary for purposes of providing basic local exchange service?
>
> A. No. ACI witness Julian states that "ACI was created with the expectation that any freedom from the long distance (interLATA) restriction of the Modification of Final Judgment (MFJ) would require that long distance service be provisioned through a separate subsidiary." (Julian Vol. 4 Tr 552). He goes on to state that it is his understanding that the federal Telecommunications Act of 1996 requires a separate

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[2]Dr. Teske is an Associate Professor of Political Science and Public Management of SUNY Stony Brook, where he specializes in political economy. He is also an Affiliated Research Fellow with the Columbia University Graduate School of Business, Institute for Tele-Information. (5 Tr 902). He has conducted much of his academic research on state telecommunications regulation and has written a book and several articles and other literature on the issues of state telecommunications regulation and telecommunications policy. (5 Tr 902-903).

subsidiary safeguard for the provision of interLATA service by a Bell Operating Company ("BOC").

Q. Are the safeguards of the federal act appropriate to protect the public interest from the possibility of anti-competitive conduct by Ameritech in the local exchange market?

A. As indicated above, the separate affiliate safeguard in the federal Act applies to the separation of the incumbent's local exchange business from the interLATA business. The federal Act is not directed at the situation presented to this Commission by the ACI application, that is, the provision of local exchange service by two competing affiliates, especially when one of those affiliates is the incumbent local exchange company.

(5 Tr 964-965).

AT&T witness Lee Selwyn, President of Economics and Technology, Inc., a telecommunications research and consulting firm, also points out that the structural separation requirements embodied in the FTA would not adequately protect against anti-competitive conduct by Ameritech in the market for basic local exchange. Mr. Selwyn explained that the separate affiliate requirements in the FTA address the relationship between a Regional Bell Operating Company ("RBOC") and its interLATA affiliate, but they do not address what relationship or safeguards should exist when the interLATA affiliate, such as ACI, is also set up to provide "one-stop shopping" (bundled local and intraLATA and/or interLATA) service. (5 Tr 785). Selwyn explained further that Congress established these separate subsidiary requirements in the FTA specifically to prevent RBOCs from extending their monopoly market power in the local exchange market into the long distance market, and that it expected certain safeguards to remain in effect for three years during which the separation requirement would remain in place in order to protect against anti-competitive behavior by the incumbent monopoly RBOC. (5 Tr 785-786, 812-813).

IV. THE RECORD EVIDENCE DEMONSTRATES THAT ACI, AMERITECH MICHIGAN AND THEIR AFFILIATES CAN STILL UNDERTAKE ANTI-COMPETITIVE BEHAVIOR TO GAIN AN UNFAIR COMPETITIVE ADVANTAGE IN THE MARKET FOR LOCAL EXCHANGE AND OTHER TELECOMMUNICATION SERVICES

The ALJ bases his recommendation to grant ACI a license in part on the grounds that statutory proscriptions against anti-competitive behavior exist and that he does not believe it is reasonable to assume that ACI or its affiliates would violate these statutory provisions. (PFD, pp 15-18). In making this determination, however, the ALJ failed to consider the substantial record evidence in this proceeding which demonstrates the great potential for anti-competitive conduct by Ameritech affiliates, despite the existence of these statutory prohibitions and the history of the transactions to date between ACI and Ameritech which underscores and affirms these concerns.

TCG Detroit witness Dr. Paul Teske testified as to the significant potential for anti-competitive conduct by ACI and Ameritech:

> The parent monopoly firm has an incentive to provide an advantage to a new competitive affiliate venture, and no structural separation or policing policy can be expected to completely prevent such behavior. In addition, in a situation in which numerous affiliates exist, such as the intermediary role played by Ameritech Information Industry Services (AIIS), which would be the actual provider of Ameritech Michigan services to ACI, the potential for anti-competitive behavior to gain a competitive advantage is increased.

(5 Tr 907). Dr. Teske, as well as other witnesses in this proceeding, pointed to numerous types of anti-competitive behavior which the Ameritech affiliates could undertake, enabling them to gain an unfair competitive advantage to Ameritech and impeding the emergence of competition in Michigan.

A. There Is A Significant Potential For Cross-subsidization By Ameritech Of Its Affiliate ACI

The record is replete with evidence indicating the potential for cross-subsidization of ACI by Ameritech. First, ACI represents that its parent Ameritech will be providing the full financial backing to ACI and stand behind its financial obligations in order to get its operations running and to provide service to each person requesting service in the territories which it intends to serve. (4 Tr 399-400, ¶¶ 8 and 11 of Application). ACI also states, that in doing so it will not encumber or pledge any of the assets of Ameritech's local exchange operations. (3 Tr 400, 4 Tr 423). Patrick Earley, ACI's Vice-President of Finance and Administration, testified, however, that he does not know which financial assets of Ameritech's local operations will not be pledged or otherwise encumbered, (4 Tr 423), or what financial and managerial resources would be required to provide service to each person requesting service in the Michigan exchanges to which the requested license pertains. (4 Tr 419). Although the ALJ was astonished at Mr. Earley's lack of knowledge regarding ACI's operations, (PFD, pp 8-9), the ALJ apparently did not find this ignorance of sufficient concern to determine that ACI lacked the management resources necessary to provide basic local exchange service. However, Mr. Earley's ignorance as to ACI's operation's, and the unsettling history of the financial transactions between ACI and Ameritech to date are sufficient cause for concern about ACI's and Ameritech's anti-competitive behavior, demonstrate how much of a potential there is for anti-competitive behavior by Ameritech and ACI.

For example, Mr. Earley testified that Ameritech Corporation had already "loaned" as of the date of his testimony, approximately $90 million in investments to ACI (4 Tr 426). However, Mr. Earley could not identify how much of that investment is related to providing service in Michigan. (4 Tr 449). Nor could he identify whether Ameritech had a maximum or minimum financial commitment to ACI or how much of Ameritech's financial commitment would be targeted to local exchange service versus long distance service. (4 Tr 440-441). Indeed, Ameritech's cavalier approach to funding ACI underscores the potential for cross-subsidization. During cross-examination of Mr. Earley, it was discussed that <u>all of the money which was being provided by Ameritech to ACI to date</u> has been in the form of <u>unsecured debt</u>, and that these monies were provided pursuant to an oral agreement only no written document which describes terms and conditions of these loans was produced. (4 Tr 455). This may explain why Mr. Earley could not identify what the terms of these loans are nor what the payback period is. (4 Tr 456). Mr. Earley also testified that the $90 million of charges incurred to date by ACI was split between direct versus non-direct charges. However, he could not identify the split between these charges. Important for the Commission to also consider is that ACI did not produce with its application in this case any documents, including an annual financial statement or balance sheet, which might help to identify the split between direct versus non-direct charges. (4 Tr 426-428). Apparently, the ALJ ignored this evidence in making his findings

TCG Detroit witness Teske's testimony encapsulates why these affiliate transactions between Ameritech and ACI are cause for concern:

> Q What statements of ACI witnesses confirm that there are no checks on the transfer of resources and assets between ACI and Ameritech Michigan?
>
> A. ACI witness Earley states in cross-examination that some expenses are not being incurred directly by ACI, but rather are being incurred indirectly. (Tr. at 425, ln. 18). He identifies the expenses being incurred indirectly as "the time for various support groups that may be happening throughout Ameritech that are capturing that time and cross-charging it to ACI." (Ibid). In contrast, Mr. Earley states that ACI is directly incurring the payroll for the "200 or 200-plus dedicated employees" of ACI. (Tr. at 425, lns. 15-17). He later states that ACI has no employees "at this point." (Tr. at 451, lns. 5-6). In combination these statements suggest that Ameritech

Michigan, or another one of its affiliates, have employed more than 200 people solely as a resource for ACI, and in addition, are providing support from other Ameritech Michigan personnel.

Mr. Earley states that the total amount of charges incurred to ACI to date is approaching $90 million, but that he doesn't "have a split of direct versus non-direct" expenses. (Tr. at 426, lns. 8-18). In addition, he states that the internal management reports supported by the underlying detail needed to identify the directly incurred versus the indirectly incurred expenses were not provided in ACI (sic) Application.

Q. Can you explain why these statements are a cause for concern?

A. Yes, First, when read together, it is my opinion that Mr. Earley has stated that cross-subsidies from Ameritech Michigan to ACI have taken place, and continue to take place. Second, he states that not only is he, as Vice-President of Finance for ACI, not aware of their magnitude, but that the information needed to identify the magnitude of the transfer of expenses incurred by ACI and absorbed by Ameritech Michigan has not been provided to the MPSC in ACI's Application.

Q. Are there other statements of ACI witnesses that cause concern about the affiliate transactions between Ameritech Michigan and ACI?

A. Yes, Mr. Earley states in cross-examination that ACI "will be acquiring assets in numerous fashions, either directly or indirectly" and that "up until that time we do start servicing customers there may be an occasion where we acquire them on an indirect basis." In addition, Mr. Earley states that ACI has been funded by Ameritech in the amount of approximately $90 million on an unsecured basis, and that "in excess of 95" of this amount is debt. He states that first, there is no written agreement to reflect this debt funding, and second, that the time period for payback of the debt is unspecified. (Tr. at 455, ln. 6 to 456, ln. 23).

Q. Please explain why these statements are a cause for concern.

A. My understanding of Mr. Earley's statement regarding asset acquisition is that ACI will acquire assets "indirectly" through the mechanism of having Ameritech Michigan incur expenses to acquire assets for the use of ACI. This is a textbook case of cross-subsidy, and definitely eradicates any notion that Ameritech Michigan and ACI are operating as separate affiliates. Mr. Earley's statements regarding the funding of ACI through Ameritech Michigan debt without a written agreement, or any plan to pay back the funds, classifies this arrangement as more of a gift than a loan, or other bona fide financial arrangement. ACI is a separate affiliate of Ameritech Michigan only in form, but not in practice. Of equal concern is the appearance that ACI's executive officers are oblivious to the need for the separate affiliate transactions between Ameritech Michigan and ACI.

(5 Tr 911-913). (Emphasis added)

B. The ALJ Erred In Not Recognizing The Significant Potential That Ameritech Michigan Will Discriminate In Favor Of Its Affiliate ACI Over Other Competitors

ACI states that it intends to provide basic local exchange service on a resold basis, and as ACI witness Teece admits, it is likely to purchase such services for resale from its affiliate Ameritech Michigan. (3 Tr 203). Mr. Teece's admission demonstrates that Ameritech Michigan is capable and willing to discriminate in favor of its affiliate ACI over other basic local exchange resale providers and thus would attempt to secure Ameritech's dominance in the basic local exchange market, as well as use this leverage to gain a competitive advantage in the market for "one-stop shopping" of bundled local exchange and interLATA service. In his PFD, the ALJ did not consider the substantial record evidence which shows the inherent incentive by Ameritech Michigan to discriminate in favor of ACI, nor the apparent lack of adequate means of monitoring such preferential treatment by ACI. For example, ACI witness Julian admitted that they have no plan in place to determine whether it is in fact getting better service from Ameritech Michigan than another unaffiliated carrier so as to ensure nondiscriminatory treatment. (4 Tr 609) Further, TCG witness Teske testified on Ameritech's incentive and ability to provide services to other affiliates at more favorable rates, terms, and conditions, at better quality, and in a more timely manner than to unaffiliated competitors:

> Q. Could Ameritech and its affiliates gain a competitive advantage through the provision of services at more favorable rates, terms, and conditions, at better quality, and in a more timely fashion to its affiliate ACI than to an unaffiliated competitor?
>
> A. Yes, Ameritech has an incentive to provide services in a way that discriminates in favor of its corporate sibling. This is true for a broad range of critical services and functionalities that ACI's competitors require, including interconnection arrangements, unbundled network elements, number portability services, and accesses to databases. Non-service advantages can also be provided to ACI. For example, the assignment of Ameritech personnel to ACI transfers valuable experience and knowledge of Ameritech's business operations to ACI. Although not all of ACI's officers came from Ameritech, about 40% did come directly from Ameritech to ACI. Further movement of personnel between the two affiliates creates the very real possibility of inappropriate information sharing.

(5 Tr 908-909).

C. The ALJ Erred in Not Considering Evidence Which Showed The Significant Potential Of Ameritech Leveraging Its Monopoly Power To Exploit Market Segregation And Impede Competition In The Markets For Basic Local Exchange And InterLATA Services.

ACI's affiliate relationship with Ameritech Michigan and its status as a duplicate affiliate provider of local exchange (as resold or facilities-based) and interLATA services raises special cross-subsidization concerns and contributes to Ameritech gaining an unfair competitive advantage in the markets for such services. The ALJ states that additional safeguards and conditions on a license for ACI would be unnecessary and burdensome on ACI. TCG disagrees. The granting of a license to